SUNWEST BANK NEWSLETTER | AUGUST 2023

Market Data

Interest Rates	Current	Month Ago	Year Ago
Bank Rates (As Of 7/31)			
WSJ Prime	8.50%	8.25%	5.50%
1 Month Term SOFR	5.32%	5.10%	2.33%
Fed Funds Rate	5.33%	5.07%	2.33%
30 Year Mortgage Fixed	6.81%	6.71%	5.30%
Treasury Rates (As Of 7/31)			
10 Year	3.95%	3.81%	2.67%
7 Year	4.07%	3.97%	2.70%
5 Year	4.17%	4.12%	2.70%
3 Year	4.51%	4.49%	2.82%
1 Year	5.38%	5.41%	2.95%
1 Month	5.37%	5.19%	2.19%
1-Month SOFR Term SOFR Swap Rates (As Of 7/31)			
10 Year	3.64%	3.50%	2.33%
7 Year	3.74%	3.64%	2.30%
5 Year	3.90%	3.84%	2.37%
3 Year	4.30%	4.29%	2.62%

Inflation Data	Current	Month Ago	Year Ago
CPI Headline YoY	3.1%	4.1%	8.9%
CPI Core YoY	4.9%	5.3%	5.9%
PPI Headline YoY	0.1%	0.9%	11.2%
PPI Core YoY	2.6%	2.8%	6.4%

Economic Data	Current	Month Ago	Year Ago
PMI Manufacturing	49.0	46.3	52.3
PMI Services	52.4	54.1	47.0
Case/Shiller U.S. Home Price Index	305.2	301.5	306.6
Housing Permits	1,441k	1,496k	1,701k
Housing Starts	1,434k	1,559k	1,561k
Retail Sales	$601b	$599b	$597b
Unemployment Rate	3.6%	3.7%	3.6%
Non-Farm Payrolls	+209k	+306k	+370k

LETTER FROM THE CEO

Storms Brewing in Commercial Real Estate

The headwinds have presented themselves for the commercial real estate (CRE) markets, particularly for commercial office. We are starting to see the signs of deterioration, with several prominent urban market office buildings being put back to the banks or to the CMBS market by their owners. In June, CMBS delinquencies rose to 3.90% compared to the 2.94% recorded at the beginning of the year. This is being driven both by higher vacancies and higher interest rates. Office property delinquencies are up to 4.50% compared to 1.68% a year ago. This dynamic is particularly playing out in large metropolitan coastal cities, which were once the hottest markets in the country. Places like San Francisco are experiencing record-high office vacancy rates, with 28.3 million square feet or nearly 500 football fields worth of available space. Additionally, interest rates on 7-year Treasurys have increased from 0.65% at the start of 2021 to over 4% today. Many real estate owners who have upcoming maturities are seeing a doubling of their monthly interest payment, in which case they are forced to put in additional equity to pay down the loan to continue to afford the higher interest costs and to satisfy the lender's loan to value requirements or default and hand the keys over to the lender.

The big problem developing is that the U.S. faces a wall of loan maturities in the next 24 months, and many real estate owners do not have the cash or the willingness to pay down their loan. The commercial real estate loan market will have around $425 billion of maturities in 2023 rising to roughly $475 billion in 2024. The scope of this problem gets much larger when you out to 2027 as $2.75 trillion loans mature, half of all outstanding commercial mortgages. As a result of these dynamics, the regulatory agencies, banks, and capital markets are becoming deeply concerned, which will only compound the lack of liquidity in the commercial office market. Most of the banking industry has already shut down, or at a minimum, significantly curtailed lending to commercial office. The CMBS market is not a good option either for office owners because of its unwillingness to take commercial office loans, but for loans with strict underwriting terms. As a result, a perfect storm has brewed for the office market; falling occupancies, rising interest costs, and lack of financing.

Default rates are expected to soar, causing property owners and lenders to take significant losses over the next few years. Property owners will face the hard decision, depending on whether they personally guaranteed the loan, of continuing to carry a struggling asset or putting the property back to their lender and walking away from their invested capital. Lenders will be faced with the difficult decision of either providing loan modifications and extensions to borrowers with the hope that time will improve the market, or demand loan payoffs at maturity. For both owners and lenders, difficult negotiations and hard decisions lie ahead.

The lack of liquidity is not only focused on commercial office space but is now impacting other areas of commercial real estate. A recent survey by the Federal Reserve of Senior Loan Officers stated that 74% were tightening their lending standards for construction loans, and 65% were tightening standards for multifamily loans. The regulatory agencies have put a microscope on the exposure banks have to commercial real estate, which will exacerbate the banks' lack of willingness to lend.

Equity Markets	Current	Month Ago	Year Ago
Indices (As Of 7/31)			
DJIA	$35,560	3.32%	8.42%
S&P 500	$4,589	2.99%	11.42%
NASDAQ	$14,346	3.83%	15.98%

Sports Fact of the Month:

In January 2016 it was announced that SoFi Stadium would be constructed in Inglewood, CA, and over the next 5 years median home prices nearly doubled to $655k

Another ramification of the collapse of commercial office values will be felt by many of our biggest cities. Assessed values, and thus property tax revenue, are collapsing in most cities, particularly in places like San Francisco, New York, Washington D.C., etc. Communities that rely on the taxes from commercial real estate and the businesses that service CRE like construction, lending, insurance, and a variety of other service businesses will take a meaningful hit. This will have a deleterious impact on those cities that are already struggling post-COVID and the riots of 2020. The question is whether this downturn in commercial real estate will have the same damaging effect that the commercial real estate implosion of the late 1980s and early 1990s had on the overall economy and financial services industry.

Having the right bank partner could make or break your business in this environment. At Sunwest we have more capital, nearly double the reserves as our competitors, and a great team that is ready and able to help you grow your business.

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